



State Investment Commission
Monthly Meeting Minutes
Wednesday, October 26, 2016
9:00 a.m.
Room 205, State House

The Monthly Meeting of the State Investment Commission (SIC) was called to order at 9:03, Wednesday, October 26, 2016 in Room 205, State House.

I. Roll Call of Members

The following members were present: Mr. Robert Benson, Mr. J. Michael Costello, Mr. Thomas Fay, Mr. Frank Karpinski, Ms. Marie Langlois, Ms. Sylvia Maxfield, Ms. Paula McNamara, Mr. Thomas Mullaney, Ms. Marcia Reback, and Treasurer Seth Magaziner.

Also in attendance: Mr. John Burns, Pension Consulting Alliance (PCA), general consultant; Mr. Thomas Lynch, Cliffwater LLC, consultant; Ms. Lisa Churchville, Treasury Chief Operating Officer; Mr. Tim Nguyen, Treasury Chief Investment Officer (interim); Ms. Sally Dowling, Adler, Pollock & Sheehan, legal counsel; and other members of the Treasurer's staff.

Treasurer Magaziner called the meeting to order at 9:03 a.m.

II. Approval of Minutes

On a motion by Mr. Mullaney and seconded by Mr. Costello, it was unanimously **VOTED: to approve the draft of the minutes of the September 28, 2016 meeting of the State Investment Commission.**

III. Recommendation to Update the Investment Policy Statement

Treasurer Magaziner noted the necessity in updating the Investment Policy Statement (IPS) since the board had approved the new asset allocation; however, he stated that the process would be conducted over the course of several months as the task is a major undertaking. The first item to be added to the IPS is language relating to the newly approved Crisis Risk Offset (CRO) class. He asked the board if there were any questions or concerns related to the drafted CRO portion of the IPS.

The board expressed concern about the benchmark index used in the drafted IPS as it differed from the index presented during the asset allocation study, as well as which horizon signals were used to identify trends. Mr. Burns and Mr. Nguyen said they would gather more information related to benchmarking and address the issues at the following meeting.

IV. Asset Allocation Transition Update

Mr. Burns outlined the major milestones needed to get the new portfolio up and running. The CRO class is a priority, as is adding a Cash Sweep Manager. The Investment Policy Statement will also need to be redrafted to include the CRO, and the Income and Growth Classes. Other implementation activities to complete in the first half of 2017 include Income Class structural reviews, revising the performance reporting format, and conducting evaluations and recommendations to Income Class and Private Credit managers.

Mr. Nguyen pointed out the timeline is flexible. Many of the items are administrative and there may be times issues will need to be moved up or pushed back to maximize their impact.

Treasurer Magaziner insisted the process be done correctly, not just quickly.

Mr. Nguyen relayed that it had been a busy month developing the transition timeline, coordinating the redemptions with new funding assignments, as well as planning the structure of the systematic trend development program. He then went on to discuss those challenges. In order to better identify and control such challenges in the future, Mr. Nguyen spoke about the creation of a risk dashboard. The purpose of the dashboard would be to create better visibility of changes that could occur in the marketplace, allowing for improved approaches to those changes. It would also allow staff to conduct modeling and more in-depth analysis internally.

V. Private Equity Performance and Illiquid Pacing Update

Mr. Lynch reported on Private Equity performance over the quarter ending June 30. Since inception, the annualized IRR is 13.4% and the return on total invested capital is 1.48, meaning that for every dollar invested there has been a \$1.48 return.

He summarized the performance in relation to both public equities and the private equity universe. The portfolio (13.23%) has well outperformed public equities benchmarks, Russell 3000 7.69% and the MSCI ACWI 5.17%, since inception.

The performance versus the private equity universe is a bit more complex as Rhode Island's investments have outperformed the private equity benchmark in some years, and underperformed in others. Treasurer Magaziner stated that consistent pacing will be imperative going forward in regards to private equity in order to avoid the peaks and valleys of varying private equity universe performance across future vintage years. In the coming months, Treasurer Magaziner also said there should be a conversation about all investments made in the private equity universe to ensure the portfolio is invested in appropriate funds relative to its size and purpose. For example, since inception, overall private equity relative to the benchmark has done well but venture capital has underperformed: is this an area that should be maintained?

The board asked questions.

Mr. Lynch then provided the Illiquid Pacing update. He explained that illiquids, under the new asset allocation, include private equity, private credit and opportunistic real estate under the umbrella of the growth asset class. He reminded the group that the illiquid asset classes are currently implemented through closed end, fixed term, commitment based drawn down funds. Modeling and pacing is important to illiquid categories in order to get precision to forecast how the portfolio will realize targets. He detailed each of the three categories' pacing models, outlining the allocation increases, growth and diversification.

The board asked questions.

VI. Recommendation on Hedge Fund Redemptions

Treasurer Magaziner began by stating that the board would have to enter into Executive Session. He explained the purpose of doing so was that when discussing the hedge fund managers to be redeemed, the board can have a candid conversation that will not influence behavior other LPs in the funds.

On a motion by Ms. Reback and seconded by Mr. Mullaney, it was unanimously **VOTED: to go into Executive Session pursuant to RI General Laws Section 42-46-5(a)(7) for a matter related to the investment of public funds where premature disclosure would adversely affect the public interest.**

A roll call vote was taken with all commission members voting “aye”.

On a motion by Ms. Reback and seconded by Mr. Mullaney, it was unanimously **VOTED: to seal the minutes of the Executive Session**

A roll call vote was taken with all commission members voting “aye”.

On a motion by Ms. Reback and seconded by Mr. Costello, it was unanimously **VOTED: to come out of Executive Session**

Once the meeting was open, Ms. Dowling explained the only action taken during the Executive Session was to seal the minutes and to exit the Executive Session.

Mr. Nguyen identified the hedge funds to be redeemed as: Ascend Capital, Brevan Howard, Brigade Capital Management, Emerging Sovereign Group (formerly Carlyle Group), Partner Fund Management, Samlyn Capital, and Och-Ziff Capital Management.

On a motion by Ms. Reback and seconded by Ms. Maxfield, it was unanimously **VOTED: to redeem the indicated hedge funds in accordance with fund documents, on terms satisfactory to Treasury staff and subject to legal review.**

VII. Consideration of expanding Pension Consulting Alliance contract

Treasurer Magaziner explained that as the new asset allocation is implemented, particularly in regards to new additions such as the Income Class or items requiring increased manager diligence, it is necessary to expand the scope of PCA's services.

Treasurer Magaziner provided context for the recommendation stating he has committed to issuing RFPs for all Treasury Office contracts throughout his term simply as a matter of “good housekeeping”. He told the board the investment consultant RFPs are due to go out at the start of 2017. The purpose of the contract expansion would simply be for a short period, from the present through the RFP period (approximately 9 months), at which time PCA and/or Cliffwater would either be retained or replaced.

Ms. Reback asked for clarification as to what services each firm provides. Mr. Nguyen described each consultant's responsibility then segued into the fact there is some redundancy of services between the firms that the office would like to eliminate, namely infrastructure manager due diligence. Currently, PCA handles infrastructure for a fee of roughly one hundred thousand dollars while Cliffwater's contract already covers those services. The savings incurred by the change would be applied to engaging PCA on identifying managers for investment products as part of the new asset allocation. Mr. Nguyen asked that the infrastructure contract with PCA be terminated and have Cliffwater assist with the Infrastructure assignment.

Mr. Costello questioned the necessity of making such a change during a time when the consultants' involvement will be crucial to implementing the new asset allocation. He reasoned that it is too much work to make the change for short period of time, taking into consideration that the consultants are performing well. He added that the change to hedge funds is now saving millions of dollars in fees and the negligible cost savings from changing consultant contracts during such a crucial time would not be worth the possible disruption.

Treasurer Magaziner asked if the board would like to push back the consultant RFP process later into 2017 based on this feedback. Mr. Costello said he thought that would be appropriate. Ms. Reback agreed. Collectively, it was determined these services will be put out to RFP in the fall of 2017, with the intention of new contracts beginning in January 2018.

The board asked questions.

On a motion by Mr. Mullaney and seconded by Ms. Reback, it was unanimously

VOTED: that PCA be engaged to assist Treasury staff in issuing requests for proposals to identify managers for investment products in the Crisis Risk Offset Class, Income Class, and Cash management, and to evaluate responses thereto, such engagement to be compensation to be negotiated.

VIII. Consideration of Extension to Capital Cities Contract

Treasurer Magaziner explained that Capital Cities', the state's 529 vendor, contract is due to expire November 1. Given the volume of work with which staff is currently tasked, it would be prudent to simply extend their contract for a term of one year. He expressed that Capital Cities is doing a good job in their capacity and there have been no issues with their work.

On a motion by Mr. Costello and seconded by Mr. Mullaney, it was unanimously

VOTED: to extend the contract with Capital Cities for a term of one year

IX. Legal Counsel Report

There was no legal counsel report.

X. Chief Investment Officer Report

Mr. Nguyen gave the September performance reporting, noting that all asset classes in the portfolio posted positive returns on the month with the exception of Fixed Income. It is the seventh consecutive month the portfolio has seen gains. Emerging Markets and non-Developed Market Equities continued on their respective upswings and Developed non U.S. Equity also performed well. As it relates to the portfolio, assets under management, the \$23-million-dollar increase for the month, was due to nearly \$46 million of positive investment offset by approximately \$23 million in pension payroll expenses.

For the quarter, Private Infrastructure, Energy MLPs and Developed non-U.S. equities not only posted positive returns, they far exceeded their benchmarks. Safety assets such as Equity Hedge Funds, Real Return Hedge Funds and Credit all posted positive returns but just fell short of their quarterly benchmarks.

Mr. Nguyen provided an update on general administration topics affecting the Investments team. The office is currently scheduling interviews for both an Investment Intern and Investment Analyst, which will be welcome additions during the implementation of the asset allocation directives. He also told the board

of the new Pitchbook software acquired by the team that would be helpful in providing granular information on investment topics related to Private Equity.

He then introduced the topic of ABLE to the board and asked Ms. Churchville to provide background of the program as it is something that will fall under the purview of the SIC. ABLE allows people with disabilities, and their families, to open savings accounts for disability related expenses. ABLE is IRS sanctioned to be included with other 529 plans. ABLE savings plans are necessary as those who receive Social Security Insurance (SSI) and Medicaid are not permitted to exceed a \$2200 traditional savings threshold without having their benefits decreased. Rhode Island is too small to have an independent ABLE program so it has joined a consortium with eleven other states, to go out to bid jointly for account management services. Currently, negotiations are underway with the consortium to finalize an implementation agreement and select manager. Once this has been completed, a recommendation will be brought before the SIC for approval of the ABLE manager. Ideally, the office would like to offer the ABLE benefit to Rhode Islanders by the end of the year.

Mr. Nguyen also notified the SIC of several RFPs that will be issued, including those for the Defined Compensation (457) plans and the Defined Contribution (401a) plan. The office will hire a retirement plan consultant to assist with issuing the RFPs this winter.

XI. Treasurer's General Comments

Treasurer Magaziner shared the news that the 529 program received new ratings from MorningStar. Before transitioning from Alliance Bernstein to Ascensus, for several years the 529 plan had been negatively rated by MorningStar. However, just three months after the transition, MorningStar has rated the Advisor Sold Plan bronze and the Direct Sold plan silver, both of which are now in the top quartile nationally. The increase in rating was due to a reduction of fees and the smoothing of the glide path of age based portfolios. Treasurer Magaziner congratulated the group.

There being no other business to come before the Board, on a motion by Ms. Reback and seconded by Mr. Fay the meeting adjourned at 11:34 a.m.

Respectfully submitted,

**Seth Magaziner,
General Treasurer**